LOUISIANA STATE UNIVERSITY AND RELATED CAMPUSES LOUISIANA STATE UNIVERSITY SYSTEM STATE OF LOUISIANA

MANAGEMENT LETTER
ISSUED FEBRUARY 16, 2011

LEGISLATIVE AUDITOR
1600 NORTH THIRD STREET
POST OFFICE BOX 94397
BATON ROUGE, LOUISIANA 70804-9397

Under the provisions of state law, this report is a public document. A copy of this report has been submitted to the Governor, to the Attorney General, and to other public officials as required by state law. A copy of this report has been made available for public inspection at the Baton Rouge office of the Legislative Auditor.

This document is produced by the Legislative Auditor, State of Louisiana, Post Office Box 94397, Baton Rouge, Louisiana 70804-9397 in accordance with Louisiana Revised Statute 24:513. Five copies of this public document were produced at an approximate cost of $14.85. This material was produced in accordance with the standards for state agencies established pursuant to R.S. 43:31. This report is available on the Legislative Auditor's Web site at www.lla.la.gov. When contacting the office, you may refer to Agency ID No. 3478 or Report ID No. 80100060 for additional information.

In compliance with the Americans With Disabilities Act, if you need special assistance relative to this document, or any documents of the Legislative Auditor, please contact Wayne "Skip" Irwin, Administration Manager, at 225-339-3800.

Our procedures at Louisiana State University (LSU) and Related Campuses for the period July 1, 2009, through June 30, 2010, disclosed the following:

- For the third consecutive year, LSU and A&M College continues to have a performance-based energy efficiency contract that includes stipulated (unmeasured) savings and therefore does not comply with state law.

- An LSU System internal audit report, dated October 8, 2010, identified the following findings during an audit of the LSU School of Music.

    - The School of Music's piano technician altered the original components and functionality of a university-owned grand piano causing the school to expend $11,500 to restore it to its intended functional condition.

    - The piano technician completed non-LSU transactions/business on university property for personal payment and failed to properly disclose outside employment in accordance with university policy.

    - Employees of the School of Music circumvented the normal procurement process when purchasing pianos for the school. Furthermore, payment in full was made to a vendor even though the school never received piano parts included in the bid specifications.

    - It appears the piano technician used his position as an LSU employee to cause LSU funds to be paid to him. The piano technician enlisted an outside vendor to contract with LSU for work that the piano technician would perform through subcontractors. In return, the vendor received 7% of the funds contracted through the university. LSU paid the vendor a total of $105,074, of which the vendor paid approximately $85,295 to the piano technician and/or his company.

- The findings identified in the prior year report on LSU and Related Campuses, dated April 15, 2010, relating to weaknesses in the administration of student financial aid at LSU at Alexandria, noncompliance with state movable property regulations, misappropriation of funds - Tiger Card purchases, and inadequate controls over the LaCarte purchasing program have been resolved by management.

- No significant control deficiencies or errors were identified relating to the selected accounts for which assurances were provided to the LSU System, including cash and cash equivalents, investments, capital assets, accounts payable, deferred revenue, bonds payable, capital lease obligations, compensated absences payable, other postemployment benefits payable, net assets, student tuition and fee revenues, federal revenues, auxiliary revenues, state appropriations, education and general expenses, and auxiliary expenses.

- No significant control deficiencies or noncompliance issues were identified that would require reporting under Office of Management and Budget Circular A-133 for the following federal programs for the fiscal year ended June 30, 2010:
  - State Fiscal Stabilization Fund Program (CFDA 84.394)
  - Student Financial Assistance Cluster (CFDA 84.007, 84.033, 84.038, 84.375, 84.376, 84.063, 84.032)
  - Research and Development Cluster (various)

This report is a public report and has been distributed to state officials. We appreciate LSU and Related Campuses' assistance in the successful completion of our work.

Background

LSU and Related Campuses are components of the LSU System. The LSU System is dedicated to advancing teaching, research, health care, and medical education with facilities and programs in each of Louisiana's 64 parishes. Each institution plays a vital role in preparing students to incorporate new knowledge and new technologies into their daily lives. LSU researchers are working on developing innovations that increase the national prominence of the university system.

As the Flagship institution of the state, the vision of LSU is to be a leading research-extensive university, challenging undergraduate and graduate students to achieve the highest levels of intellectual and personal development. Designated as a Land, Sea, and Space Grant institution, the mission of LSU is the generation, preservation, dissemination, and application of knowledge and cultivation of the arts.

In implementing its mission, LSU is committed to the following:

- Offering a broad array of undergraduate degree programs and extensive graduate research opportunities designed to attract and educate highly qualified undergraduate and graduate students
- Employing faculty who are excellent teacher-scholars, nationally competitive in research and creative activities, and contribute to a world-class knowledge base that is transferable to educational, professional, cultural, and economic enterprises
- Using its extensive resources to solve economic, environmental, and social challenges

LOUISIANA LEGISLATIVE AUDITOR
DARYL G. PURPERA, CPA, CFE

January 19, 2011

LOUISIANA STATE UNIVERSITY BOARD OF SUPERVISORS,
LOUISIANA STATE UNIVERSITY,
LOUISIANA STATE UNIVERSITY AGRICULTURAL CENTER,
PENNINGTON BIOMEDICAL RESEARCH CENTER,
PAUL M. HEBERT LAW CENTER,
LOUISIANA STATE UNIVERSITY AT ALEXANDRIA,
AND LOUISIANA STATE UNIVERSITY AT EUNICE
LOUISIANA STATE UNIVERSITY SYSTEM
STATE OF LOUISIANA
Baton Rouge, Louisiana

As required by Louisiana Revised Statute 24:513 and as a part of our audit of the Louisiana State University System's (System) financial statements and the Single Audit of the State of Louisiana for the fiscal year ended June 30, 2010, we conducted certain procedures at Louisiana State University Board of Supervisors, Louisiana State University, Louisiana State University Agricultural Center, Pennington Biomedical Research Center, Paul M. Hebert Law Center, Louisiana State University at Alexandria, and Louisiana State University at Eunice for the period from July 1, 2009, through June 30, 2010.

- Our auditors obtained and documented an understanding of LSU and Related Campuses' operations and system of internal controls, including internal controls over major federal award programs administered by LSU and Related Campuses through inquiry, observation, and review of LSU and Related Campuses' policies and procedures documentation including a review of the applicable related laws and regulations.

- Our auditors performed analytical procedures consisting of a comparison of the most current and prior year financial activity using LSU and Related Campuses' financial information provided to the LSU System and obtained explanations from management of any significant variances.

- Our auditors reviewed the status of the findings identified in the prior year engagement. In our prior report on LSU and Related Campuses, dated April 15, 2010, we reported findings relating to weaknesses in the administration of student financial aid at LSU at Alexandria, noncompliance with state movable property regulations, misappropriation of funds - Tiger Card purchases, and inadequate controls over the LaCarte purchasing program, which have been resolved by management. The remaining finding relating to energy efficiency contract contrary to law has not been resolved and is addressed again in this letter.

- Our auditors considered internal control over financial reporting and examined evidence supporting LSU and Related Campuses' account balances and classes of transactions material to the System's financial statements as follows:

  - Statement of Net Assets

    Cash and cash equivalents, investments, capital assets, accounts payable, deferred revenue, bonds payable, capital lease obligations, compensated absences payable, other postemployment benefits payable, and net assets

  - Statement of Revenues, Expenses, and Changes in Net Assets

    Student tuition and fee revenues, federal revenues, auxiliary revenues, state appropriations, education and general expenses, and auxiliary expenses

  We also tested LSU and Related Campuses' compliance with laws and regulations that could have a direct and material effect on the System's financial statements. These procedures were performed in accordance with *Government Auditing Standards* as part of our audit of the System's financial statements for the fiscal year ended June 30, 2010.

- Our auditors performed internal control and compliance testing in accordance with Office of Management and Budget Circular A-133 and the following federal programs for the fiscal year ended June 30, 2010, as part of the Single Audit for the State of Louisiana:

  - State Fiscal Stabilization Fund Program (CFDA 84.394)

  - Student Financial Assistance Cluster (CFDA 84.007, 84.033, 84.038, 84.375, 84.376, 84.063, 84.032)

  - Research and Development Cluster (various)

The financial information provided to the System by LSU and Related Campuses was not audited or reviewed by us, and, accordingly, we do not express an opinion on that financial information. LSU and Related Campuses' accounts are an integral part of the System's financial statements, upon which the Louisiana Legislative Auditor expresses opinions.

Based on the application of the procedures referred to previously, we have reportable findings relating to energy efficiency contracts contrary to state law and inadequate controls over purchasing within the School of Music. We found no significant control deficiencies, noncompliance, or errors relating to our analytical procedures or our other audit procedures including our procedures on federal programs.

The following significant findings are included in this report for management's consideration.

Energy Efficiency Contract Contrary to State Law

In August 2002, LSU entered into a 15-year performance-based energy efficiency contract for a cost of approximately $3.5 million with Johnson Controls, Inc. (JCI) that includes stipulated (unmeasured) savings and therefore does not comply with state law. This is the third consecutive year for this finding. Louisiana Revised Statute (R.S.) 39:1496.1(A) provides that a state agency may enter into a performance-based energy efficiency contract for services and equipment. R.S. 39:1484(A)(14) requires the payment obligation to be either a percentage of the annual energy cost savings attributable to the services or equipment under the contract or guaranteed by the company under contract to be less than the annual energy cost savings attributable to the services or equipment under the contract. R.S. 39:1496.1(D) requires the contract to contain a guarantee of energy savings to the university. The statute further provides that the annual calculation of the energy savings must include maintenance savings that result from operational expenses eliminated and future capital replacement expenditures avoided as a result of equipment installed or services performed by the contractor.

Attorney General Opinion 07-0002 provides "…for the stipulated operational savings to be included in the total guaranteed savings, those savings must actually be guaranteed. In order for the operational savings to be guaranteed, the Contract would have to provide for some type of measurement and/or verification of the operational savings…." Although the attorney general opinion was directed to local government, the same guarantee is required in state law.

A review of the energy efficiency contract between LSU and JCI disclosed that JCI guaranteed a total of $3,427,380 in savings during the term of the contract, consisting of measurable savings of $2,614,658 and operational savings of $812,722. According to the contract, "Operational Savings are mutually agreed by the Customer and JCI …and shall not be additionally measured or monitored during the Term." The contract also stipulates that operational savings include avoided repair and maintenance costs achieved by the customer through the implementation of the Performance Contracting Agreement. The operational savings are not actually guaranteed because the contract does not provide for some type of measurement and/or verification of the operational savings. Therefore, excluding the operational savings, the guaranteed savings over the life of the contract are only the measurable savings of $2,614,658. The total payments due to JCI over the life of the contract are approximately $3.5 million. Therefore, the payment obligation exceeds the adjusted guaranteed annual energy cost savings.

At the signing date of the contract, management believed that the contract complied with state law. However, because the operational savings are stipulated and are not measurable and verifiable, the contract is not in compliance with state law. In addition, there is a risk of making payments specified in the contract that are greater than the energy cost savings attributable to the services or equipment under the contract.

The LSU System's counsel has represented to us that he has conducted detailed investigations and evaluations of the agreement, has retained an industry expert to assist in a comprehensive review of the technical materials and calculations associated with the contract, and is currently actively engaged in extensive settlement discussions with JCI's legal counsel regarding resolution of the issues associated with the contract.

Management should revise its energy efficiency contract to ensure that each savings component is verifiable and that the guaranteed savings have been realized. In addition, management should ensure that the payments required by the contract are not greater than the energy cost savings attributable to the services or equipment under the contract. LSU System management concurred with the finding and is addressing the issue as described previously (see Appendix A, pages 1-2).

Inadequate Controls Over Purchasing Within the School of Music

An LSU System internal audit report, dated October 8, 2010, identified six findings during an audit of the LSU School of Music, including lack of controls over purchasing and outside employment, noncompliance with state purchasing regulations, and a possible misappropriation of federal and state funds. It is LSU's policy that purchases are made in accordance with the Louisiana Procurement Code; the Louisiana Administrative Code Title 34 for Government Contracts, Procurement, and Property Control; and the most recent Small Purchase Procedures Executive Order. An adequate system of internal control includes procedures that ensure proper approval, documentation and support, and monitoring of purchasing transactions.

The scope of the internal audit included the examination of piano-related purchases within the School of Music during the period between July 2007 and January 2010, consideration of alleged changes to university property, and the investigation of non-LSU activities conducted for pay on university property. In their report, the LSU internal auditors noted the following findings:

- *Finding 1* - The School of Music's piano technician altered the original components and functionality of a university-owned grand piano causing the school to expend $11,500 to restore it to its intended functional condition.

- *Finding 2* - The piano technician completed non-LSU transactions/business on university property for personal payment and failed to properly disclose outside employment in accordance with university policy. The piano technician conducted freelance work on campus restoring pianos and also advertised for his freelance services on the Internet using his LSU Piano Technician title and LSU office address.

- *Findings 3 through 5* - Employees of the School of Music circumvented the normal procurement process when purchasing pianos for the school. Contract terms appear to have been negotiated and production of custom built pianos authorized prior to the required solicitation and bidding process. In addition, piano parts with an estimated cost of $25,732 were purchased with capital outlay funds after the state's Office of Facility Planning and Control had disapproved the use of the funds for that purpose. Furthermore, payment in full was made to the vendor even though the school never received piano parts included in the bid specifications. The piano technician also facilitated the trade of four pianos, two of which were not included in the original bid specifications. Inaccurate information was provided to LSU's Property Management Office resulting in incorrect inventory records.

- *Finding 6* - In unrelated transactions with a different vendor, it appears the piano technician used his position as an LSU employee to cause LSU funds to be paid to him. The piano technician enlisted an outside vendor to contract with LSU for work that the piano technician would perform through subcontractors. In return, the vendor received 7% of the funds contracted through the university. LSU paid the vendor a total of $105,074, of which the vendor paid approximately $85,295 to the piano technician and/or his company. Since the contracts were for repairs and replacement parts of pianos damaged by Hurricane Gustav, the contract expenditures were reimbursed to the university by funds from the Federal Emergency Management Agency (FEMA) and the state Office of Risk Management (ORM).

The LSU System internal audit report included numerous recommendations to management including, but not limited to, the following: (1) establish a clear job description for the piano technician position to clearly reflect management requirements and expectation; (2) reinforce that proper disclosure and approval of outside employment is required by university policy Permanent Memoradum 11; (3) ensure that employees are informed of and follow all policies regarding purchasing; (4) consider implementing appropriate central measures to ensure that all expenditures involving capital outlay funds receive Division of Administration approval prior to contract award or obligation of funds; (5) determine if the university has an obligation to repay the claim reimbursements received from FEMA and ORM; and (6) take necessary actions to recover funds related to the transactions described in the report. Management concurred with the internal audit findings and outlined a plan of corrective action for each finding. Additional information regarding this report can be obtained through the LSU System, Office of Internal Audit.

Additional procedures performed by LSU personnel noted that the total costs reimbursed by FEMA and ORM besides the $105,074 mentioned above also included supplies from other vendors of $606 and internal labor costs of $5,928 for a total of $111,608. Of this total, FEMA paid $100,664 and ORM paid $10,944. These amounts represent questioned costs. The piano technician voluntarily resigned from LSU on July 7, 2010. The East Baton Rouge Parish District Attorney has been notified.

The School of Music's piano technician disregarded various university policies and procedures and the supervision over this employee was not sufficient to prevent or detect the noncompliance. As a result, LSU may potentially have to repay the questioned costs with its state funds. In addition, these actions caused LSU to expend $11,500 to restore an item and $25,732 on items that were not received.

Management should follow the recommendations outlined in the LSU internal audit report to strengthen controls over purchasing and reduce the likelihood of noncompliance with state and federal laws and university policies. Management concurred with the finding and outlined a plan of corrective action (see Appendix A, pages 3-4).

The recommendations in this letter represent, in our judgment, those most likely to bring about beneficial improvements to the operations of LSU and Related Campuses. The varying nature of the recommendations, their implementation costs, and their potential impact on the operations of LSU and Related Campuses should be considered in reaching decisions on courses of action. The findings relating to the university's compliance with applicable laws and regulations should be addressed immediately by management.

This letter is intended for the information and use of the university and its management, others within the entity, the LSU System and its Board of Supervisors, and the Louisiana Legislature and is not intended to be, and should not be, used by anyone other than these specified parties. Under Louisiana Revised Statute 24:513, this letter is a public document, and it has been distributed to appropriate public officials.

Respectfully submitted,

Daryl G. Purpera

Daryl G. Purpera, CPA, CFE
Legislative Auditor

NMW:WDG:EFS:THC:dl

LSU&R 2010

Management's Corrective Action Plans and Responses to the Findings and Recommendations

Louisiana State University System
3810 West Lakeshore Drive
Baton Rouge, Louisiana 70808

Chief Financial Officer

225 / 578-6935
225 / 578-5524 fax

October 19, 2010

Mr. Daryl G. Purpera, CPA
Legislative Auditor
P. O. Box 94397
Baton Rouge, LA 70804-9397

Re: Audit Finding - Energy Efficiency Contract Contrary to State Law

Dear Mr. Purpera:

I am writing in response to your letter dated October 6, 2010 to Chancellor Martin regarding fiscal year 2010 Audit findings associated with a performance-based energy efficiency contract between Johnson Controls, Inc. (JCI) and LSU and also in response to your letter dated October 12, 2010 to President Lombardi with virtually identical audit findings for each of the other four LSU System institutions that are also currently party to a performance-based energy efficiency contract with JCI, specifically, the University of New Orleans, Louisiana State University Health Science Center in Shreveport, University Medical Center, and Lallie Kemp Hospital. This letter is meant to serve as the LSU System's response to any similar findings regarding each of these contracts for the 2010 fiscal year.

As noted in your findings, and in previous correspondence to your office from the LSU System (see attached), LSU System's counsel has conducted detailed investigations of each of these agreements and has retained an industry expert to assist in the review of the complex technical materials and calculations. After working with the expert and the five facilities to determine the status and history of these contracts and after attempts to obtain relevant information from JCI's out-of-state counsel, notice of default was sent to JCI on February 3, 2010. The LSU System's counsel indicated the LSU System's position with regard to each of these contracts and informed JCI that these issues must be resolved. On February 5, 2010, LSU's counsel was contacted by new, local counsel for JCI who indicated that JCI was willing to actively work to resolve the issues related to each of these contracts. Since this time, numerous meetings and correspondence have taken place between LSU System counsel, JCI local counsel and the five LSU System institutions regarding the status of each of the five contracts, the unique issues associated with performance under each contract, issues associated with savings under each contract, termination options for each contract and the most appropriate method of addressing any other issues under each contract. During the past month, JCI and the LSU System have exchanged terms associated with a proposed termination of the Louisiana State University Health Sciences Center, Shreveport contract. Currently LSU is awaiting a response from JCI on its proposed terms and hopes to move forward with similar negotiations related to each of the four other contracts in an effort to avoid costly litigation. Should negotiations be unsuccessful, LSU is prepared to institute litigation to resolve the issues associated with these contracts by nullifying the agreements, forcing amendments to the agreements or recovering for breach of the agreements.

Sincerely,

Wendy C. Simoneaux

Wendy C. Simoneaux
Chief Financial Officer

Enclosure

Cc: General Counsel P. Raymond Lamonica

LSU
LOUISIANA STATE UNIVERSITY
Finance & Administrative Services

Mr. Daryl G. Purpera, CPA
Legislative Auditor
1600 North Third Street
P.O. Box 94397
Baton Rouge, Louisiana 70804-9397

December 6, 2010

Dear Mr. Purpera:

In conjunction with the legislative audit of LSU, we wish to respond to the audit findings concerning inadequate controls over purchasing within the LSU School of Music. We concur with the findings addressed in the letter dated November 29, 2010. As requested in the letter, the following responses are issued for each finding:

Finding 1:
The School of Music's Piano Technician altered the original components and functionality of a University-owned grand piano causing the school to expend $11,500 to restore it to its intended functional condition.

Response to Finding 1: **Anticipated Completion Date: 02/28/2011**

- Policies have been put into place within the School of Music requiring written approval to proceed with a major repair or maintenance of equipment when the cost will equal or exceed $500.
- The job description for the Piano Technician position will be updated to reflect the position's scope of authority for repairs to equipment consistent with the School of Music policy.

Contact Person(s): Kristin Sosnowski, Associate Dean, College of Music & Dramatic Arts
Michael Bassford, Business Manager, College of Music & Dramatic Arts

Finding 2:
The piano technician completed non-LSU transactions/business on University property for personal payment and failed to properly disclose outside employment in accordance with University policy.

Response to Finding 2: **Anticipated Completion Date: 10/01/2010**

- The College of Music and Dramatic Arts will communicate annually the requirements of PM-11 to all faculty and staff in the College.

Contact Person(s): Laurence Kaptain, Dean, College of Music & Dramatic Arts

Finding 3:
Employees of the School of Music circumvented the normal procurement process when purchasing pianos for the School.

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Finding 4:
Payment in full was made to the vendor even though the School never received the piano parts included in the bid specifications.

Finding 5:
The Piano Technician facilitated the trade of four pianos, two of which were not included in the original bid specifications. Inaccurate information was provided to the University's Property Management Office resulting in incorrect inventory records.

Response to Findings 3, 4 and 5: **Anticipated Completion Date: 05/01/2011**

- The College of Music and Dramatic Arts will seek a cash refund for the 30 sets of action parts specified in the ITB and agreed to be the vendor.
- The College of Music and Dramatic Arts will work with Finance and Administrative Services to determine a training program for administrative functions, to be certain that the new Business Manager is fully trained as to the University's policies and procedures.
- Accounting Services will inform Facility Planning and Control of the purchase of the 30 sets of action parts and take the necessary corrective action.
- LSU Purchasing will work closely with the College of Music and Dramatic Arts personnel to review bid specifications for irregularities on an ongoing basis.
- Accounting Services will administer expenditures involving capital outlay funds.

Contact Person(s): Willis Delony, Interim Director, School of Music
Michael Bassford, Business Manager, College of Music & Dramatic Arts
Donna Torres, Associate Vice Chancellor for Accounting & Financial Services

Finding 6:
In unrelated transactions with a different vendor, it appears that the Piano Technician used his position as an LSU employee to cause LSU funds to be paid to him.

Response to Finding 6: **Anticipated Completion Date: 06/30/2011**

- In accordance with R.S. 24:523, the Legislative Auditor and the District Attorney have been advised of these transactions.
- The claim reimbursements received from FEMA and the State Office of Risk Management will be refunded.
- Advice of legal counsel is being sought to determine the necessary actions to recover funds related to these transactions.

Contact Person(s): Donna Torres, Associate Vice Chancellor for Accounting & Financial Services

If you have any questions or need any additional information, please feel free to contact me.

Eric Monday
Vice Chancellor for Finance & Administrative Services and CFO